December 11, 2009

Via email to: eaac@calepa.ca.gov

Chairman Larry Goulder
Economic and Allocation Advisory Committee
1001 I St
Sacramento, CA 95814

Re: Recommendations on Allocation and Allowance Value

Dear Chairman Goulder and EAAC Members,

Thank you for your continued efforts to guide California's response to climate change. We, the undersigned organizations, appreciate the Committee's willingness to consider public input. In this letter we provide our recommendations on (1) how to allocate allowances; (2) criteria to guide investment of allowance value; (3) the importance of adaptation; and (4) how to promote a smooth transition to a low carbon economy while achieving GHG reduction goals.

1. 100 Percent of Allowances Should be Auctioned in 2012

We support the position taken by several EAAC members, including Allowance Value Provision Subcommittee Chairman Matt Barger at the Nov. 18 meeting, that 100 percent of allowances should be auctioned from the start. Compared to the other alternatives discussed in the Draft Report, 100 percent auctioning emerges as the clear winner under the four criteria – cost-effectiveness, fairness, environmental effectiveness, and simplicity – EAAC has identified to guide its recommendations for allowance allocation.

Indeed, in their 2007 report, the Market Advisory Committee concluded that "the fundamental objectives of cost-effectiveness, fairness, and simplicity... favor a system in which California ultimately auctions *all* of its emission allowances" (emphasis added). Auctioning provides an economically efficient, simple, fair and transparent way to allocate allowances and it inherently incentivizes early actions. Furthermore, the revenue generated from auctioning will prove vital in transitioning California businesses and communities towards a low-carbon future.

2. Allowance Value Should be Invested According to the Following AB 32-Mandated Criteria

We commend EAAC for structuring the question of how to evaluate investment opportunities around the key objectives contained in AB 32. When recommending how best to invest allowance value, we encourage the Committee to weigh heavily the multiple, reinforcing objectives of AB 32:

a. Improve Air quality and Reduce Toxic Air Contaminant Emissions

AB 32 states that CARB should "prevent any increase in the emissions of toxic air contaminants or criteria air pollutants."[1] AB 32 recognizes the potential double win of reducing GHG and co-pollutant emissions simultaneously. Any investment of allowance value that yields double benefits ought to receive priority over investments that only address GHG emissions.

b. Maximize other environmental benefits

AB 32 states several times that implementation should maximize the air quality, environmental, public health and other co-benefits.[2] CARB should seek investment opportunities that maximize environmental benefits beyond those listed above, including ecosystem restoration and protection for water quality and quantity, air quality, public health preparedness, climate regulation, fish and wildlife habitat, and resource-dependent economies, among other strategies to help California's natural systems, working lands, and human communities adapt to climate change.

c. Disadvantaged Communities

AB 32 is clear that implementation should "ensure that activities undertaken to comply with the regulations do not disproportionately impact low-income communities."[3] Pertaining to market based systems, AB 32 requires consideration of "… the potential for direct, indirect, and cumulative emission impacts from these mechanisms, including localized impacts in communities that are already adversely impacted by air pollution."[4] Further, AB 32 seeks to "direct public and private investment toward the most disadvantaged communities in California."[5] With these goals in mind, allowance value investment opportunities that generate new, high-quality employment, initiate or expand energy efficiency and pollution control technology programs, provide for energy efficiency and mass transit oriented improvements without compromising environmental quality, in our historically disadvantaged communities ought to be top priorities.

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[1] California Health and Safety Code § 38570(b)(2).
[2] *Id.* at §§ 38562(b)(1),(4),(6); 38570(b)(1)-(3); 38501(h).
[3] *Id.* at § 38562(b)(2).
[4] *Id.* at § 38570(b)(1).
[5] *Id.* at § 38565.

3. Adaptation

While we must reduce GHG emissions to prevent the most serious effects of global warming, a certain amount of warming is now unavoidable. As a consequence, AB 32's goals to protect our air quality, public health, environmental co-benefits and disadvantaged communities will be undermined without significant investment in strategies for communities and ecosystems to adapt to global warming.

Such strategies should include, but are not limited to: 1) public health preparedness for communities that are vulnerable and exposed to increased extreme heat days and diminished air quality; 2) conservation and restoration of natural systems and working lands (i.e. agriculture and timber) to protect water quality, climate regulation and habitat, and reduce vulnerability to catastrophic fire, pests and disease; and 3) improved land use and transportation planning to improve air quality, reduce chronic illnesses, and protect natural systems and communities. California's 2009 Climate Adaptation Strategy calls for such activities, for example citing the need for "public health research, adaptation and climate resiliency education that addresses Environmental Justice."[6]

4. Preventing Leakage

a. Broader program

The best way to avoid leakage of economic productivity and associated employment from California to other states or countries is through a consistent and coordinated national and international climate program, respectively, so that firms in all jurisdictions face an equal playing field.

b. Avoid windfall profits

The AB 32 cap and trade program should avoid free allowance allocation to firms with a potential to realize windfall profits. This rule should hold even if free allowances are intended to combat leakage for energy-intensive, trade-exposed industries. As acknowledged in the Draft EAAC report, free allowance allocation in the European Union Emissions Trading System resulted in "billions of dollars of windfall profits" and thus led to a "transition to a full auction..."[7]

c. Transition assistance; not persistent compensation

If CARB does provide free allowances to trade exposed, energy intensive industries, it should be for near-term transition assistance rather than persistent compensation. The assistance should be provided with careful oversight and legally enforceable requirements for investments in low-carbon technologies or practices. If regulatory overseers determine that administrative allowance allocation is resulting in windfall profits, failing to prevent leakage, or not being utilized to hasten transition to a low-carbon business model, then free allocation should cease and the value of allowances intended to aid transition should be returned to the people of California. Also, in considering the issues documented in EAAC draft reports, we

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[6] California Natural Resources Agency, *2009 Climate Adaptation Strategy*, December 2, 2009, p. 44; available at: http://www.energy.ca.gov/2009publications/CNRA-1000-2009-027/CNRA-1000-2009-027-F.PDF.
[7] EAAC Draft Report, November 16, 2009, p. 14.

recommend that any allowance allocation should be output based with performance benchmarking, and should have clear, near-term termination timelines as the AB32 cap and trade program moves quickly to auctioning 100% of allowances.

d. Data

CARB should make good on it's commitment to produce a data-rich analysis of industries facing leakage concerns. To the extent that CARB has provided data or research findings to EAAC on this issue, CARB's work should be made available to the public. Researchers in the European Union have demonstrated methods for evaluating leakage risk, and those same methods can be employed to identify industries in California facing the greatest costs from climate policy (in the form of higher energy rates and GHG allowance obligations) and greatest competition from importers.

Sincerely,

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